WPS 2518

POLICY RESEARCH WORKING PAPER 2518

Can Reforming Global Institutions Help Developing Countries Share More in the Benefits from Globalization?

Andrés Solimano

Globalization has expanded both opportunities and risks. How should responsibilities be allocated (and coordinated) between the global financial institutions that developed in the 1940s and the regional financial institutions that began developing in the 1960s? Can growth-oriented policies be harmonized at national and global levels to reduce volatility and promote social equity?

The World Bank
Development Research Group
Macroeconomics and Growth
January 2001

Summary findings

Globalization could significantly expand trade, international investment, and technological advances, but the gains from global integration have been unevenly distributed across and within nations. Greater global interdependence has also brought greater macroeconomic volatility, resulting in several serious financial crises in the second half of the 1990s.

The global matrix of Bretton Woods and United Nations institutions that developed starting in the 1940s formed under a different balance of power, in a world of fixed exchange rates and limited capital mobility. Since the 1960s regional financial institutions have emerged because of the greater autonomy of different regions and the greater financial needs of development.

Solimano reviews different proposals for reform of the international financial institutions and changes in the roles of the International Monetary Fund (IMF) and the World Bank. He highlights the implications for developing countries of:

- Policy conditionality.
- The countercyclical role of multilaterals' lending.
- Greater lending to middle-income than to low-income developing countries.
- Access to liquidity at times of crisis.
- Mechanisms for giving low-income countries a greater voice in IMF and World Bank decisionmaking.

Solimano stresses the overlapping responsibilities of the Bretton Woods and regional financial institutions and the need to reassess the allocation of responsibilities and to develop better coordination mechanisms between these institutions. Those designing institutional reform must consider the corporate capabilities of each type of institution. The corporate cultures of global and regional institutions differ. So does the kind of knowledge they generate and disseminate, and so do patterns of interactions with, and mechanisms for representation of, client countries.

Finally, Solimano calls attention to the need to harmonize national and global growth-oriented policies in a way that reduces volatility and promotes social equity.

This paper—a product of Macroeconomics and Growth, Development Research Group—is part of a larger effort in the group to understand the impact of globalization on developing countries. Copies of the paper are available free from the World Bank, 1818 H Street NW, Washington, DC 20433. Please contact Rina Bonfield, room MC3-354, telephone 202-473-1248, fax 202-522-3518, email address abonfield@worldbank.org. Policy Research Working Papers are also posted on the Web at www.worldbank.org/research/workingpapers. The author may be contacted at asolimano@worldbank.org. January 2001. (30 pages)

Can Reforming Global Institutions Help Developing Countries Share More in the Benefits from Globalization?

by

Andrés Solimano[1]

The World Bank

[1] E-mail Address for comments: Asolimano@worldbank.org

Introduction

Globalization has become both a household term and an important historical phenomena. It has followed the end of the cold-war, the collapse of communism and a reconfiguration in the balance of power towards western countries and capitalism. Globalization, impulsed by dramatic technological improvements in telecommunications, information technology and a sharp cut in transport costs can be a powerful engine for wealth creation and prosperity. On the other side however, globalization also tends to generate financial crisis and volatility and its social effects can be adverse. In view of these elements, globalization poses an important challenge to the institutional matrix, created in the mid 1940s, composed by the United Nations system, the Bretton Woods institutions and the World Trade Organization (successor of GATT). In turn, at national level globalization tends to reduce the degree of effective autonomy for national governments to pursue their own development goals of growth, stability and social equity. A main challenge of public policy in the era of globalization is the seizing of the opportunities it opens while at the same time managing the tensions and problems it poses, particularly, for developing countries.[2] This requires, among other things, addressing the adequacy of the institutional framework, (or governance structure), accompanying globalization, a main subject of this paper.

The paper is organized around several sections. First, it provides an historical background on early and late 20th century globalization episodes and other main

[2] The paper draws, partially, on ideas stated in Solimano (1999) and new developments in the subject of globalization. The views are of the author and should not necessarily ascribed to the institutions he belongs.

developments of the last 100 hundred years, or so, to put the current wave of globalization in historical perspective. Then the paper reviews, briefly, main analytical views, both orthodox and heterodox, on globalization and development and examines the opportunities, tensions and dilemmas posed by globalization. Then it turns to the institutional challenge of making globalization more compatible with global stability and national development and reviews current proposals for international financial reform.

The paper highlights both the need for re-examining the mix (and sometimes overlapping functions) between global and regional financial institutions and the consistency between reform of global and regional institutions and changes in national policies and institutions. The relative roles and allocation of responsibilities of global and regional institutions need to be analyzed and evaluated in terms of the following criteria: value of regional versus global knowledge, patterns of interaction with borrowing countries, capacity of response of international financial institutions (IFIs) to crisis in medium-size and small countries, voice and representation for developing countries and transition economies in the IFIs. In addition, the paper argues the need for harmonization between global and national policies around an agreed set of policy priorities; also the paper posits that national policies must be oriented towards reducing volatility and equalizing opportunities among all members of society in order to enable steady growth with equity.

Historical Background

The last decades of the nineteenth century (say from the 1870s) to the early twentieth century (up to 1914) was a period of rapid growth of the global economy based on the expansion of international trade and free capital mobility under the gold-standard. This came to an end with the disarray brought about by World War I, which in turn was followed by a period of high inflation and macroeconomic turbulence in the 1920s in several major European economies and thereafter, by the Great Depression of the 1930s.

These events, in turn, radically reshaped prevailing ideas on how to stabilize global and national economies and the role of international trade and capital movements as engines of growth and prosperity. Global capitalism was seen an inherently unstable system; prone both to periods of volatility and inflation, as in the 1920s, or to recessionary trends without self correcting mechanisms that assure full employment, as it was patently demonstrated in the 1930s.

A new set of global financial institutions emerged in the mid 1940s, known as the Bretton Woods Institutions. The International Monetary Fund was given the mandate of assuring a normal payments system under a system of fixed exchange rates, and providing external financing to countries running balance of payments deficits. The role of the World Bank was to provide long term financing for economic reconstruction and development.

A period of considerable stability, rapid growth and prosperity lasted from the late 1940s to the early 1970s; this period, called the “golden age of capitalism”, was based on a (globally and nationally) regulated market economy. This regulated market economy could be defined by a myriad of global and regional institutions in charge of providing stability and development assistance, complemented by national institutions such as the “welfare state”, in industrial countries and a “developmentalist state”, in developing countries, oriented to assure social protection and shared growth. The state also was to implement counter-cyclical macroeconomic policies oriented to maintain full employment. The "golden age of capitalism" ran out of steam in the industrial economies with the two oil price shocks and the ensuing stagflation during the 1970s. Developing countries, in turn, borrowed heavily in the 1970s, a process that led to the debt crisis of the 1980s.

Large macro imbalances were corrected in the 1990s in Latin America, inflation declined and economic growth resumed, coinciding with the return of capital flows to the region and the deepening of reforms. Nevertheless, annual GDP growth averaged only 3.3% in the decade, still a moderate pace of output expansion, (punctuated by recessionary cycles in 1995 and 1999), to significantly reduce poverty and improve living standards in the region.

In the 1990s there were recurrent episodes of financial instability such as the Mexican crisis of 1994, the Asian crisis of 1997, the Russian crisis of 1998 and the Brazilian crisis of early 1999. Globalization, boosted by the adoption of market-oriented economic policies in developing countries and transition economies, is being accompanied by substantial financial volatility characterized often coming with currency crisis of high frequency and intensity.

Interestingly, the global economy of the late 20th century resembles, in several respects, the pre-1914 liberal economic order in the sense of a more open regime for international trade and foreign direct investment and capital movements.

There are, however, several differences, between pre-1914 and late 20th century globalization. First, the degree of capital mobility of late 20th century globalization in both currency markets and in bonds, equity, short-term credit and other financial instruments is of unprecedente nature in history. Second, in early 20th century globalization, there were no global financial and political institutions aimed at stabilizing the world economy, financing development, setting global rules for international trade in goods and services (the World Trade Organization), and provide a political and diplomatic forum to settle disputes among states and address a host of other global issues such as the United Nations. Third, there was a change in the leadership (e.g. "hegemony") in the two waves of globalization. The first one was led by England as the dominant "superpower" in the late 19th century. The international monetary system was anchored around the British pound and the gold standard.[3] In contrast, in the second globalization wave of the late 20th century, the process is led by the United States and the U.S. dollar under a flexible exchange rate regime. Fourth, pre-1914 globalization came across with mass migrations particularly from Europe to the 'new world' that included the U.S., Canada, Australia, Argentina. In turn, late 20th century globalization is coming along also with relatively significant migration flows (although of less magnitude in relation to the total population of recipient countries) and movement of people across countries and continents.

Thinking on Globalization: Orthodox and Heterodox Views.

Globalization involves increased trade in goods and services, and enhanced financial integration. In addition, globalization implies particular patterns of insertion of developing countries in the world economy, its institutional architecture and other forms of global power relations.

[3] For an interesting discussion of the effects of the international monetary system on the main political

Neoclassical theory supports free trade on grounds that economic integration bolsters a more efficient structure of production and expanded consumption opportunities that, in turn, must lead to higher national (and world) income and welfare.

The case for free capital mobility is more contentious, even in the framework of neoclassical theory. On the one hand, it is recognized that removing barriers for capital to go from areas with lower rates of return to countries with higher rates of return must increase global real income, and contribute to the saving pool of recipient countries which are often capital-scarce economies. However, speculative short term capital mobility can be also destabilizing and promoting free capital mobility is not a guarantee of stable, speedier, growth for recipient countries.

In fact, neoclassic trade theorists such as Jagdish Bhagwati (2000) makes a distinction between free trade and free capital mobility, noting that both forms of economic integration are not equivalent in terms of their economic rewards because of the speculative nature of short term capital inflows. This believes is also shared by Nobel-prize James Tobin, who has proposed a small tax on international financial transactions to reduce excessive capital mobility across countries. In general, this literature is favorable to globalization understood as trade integration but more eclectic when dealing with capital flows, particularly of short term nature.

Unorthodox theories such as center-periphery, dependency theory and unequal exchange were developed in the 1940s and 1950s by authors like Prebisch (1950), Emmanuel (1972) and formalized by Bacha (1978) and Taylor (1983). Although these theories were developed well before the current process of globalization, that started in

---

events of the 20th century, see Mundell (2000) the 1980s and 1990s, they still can help to identify issues related to the current globalization wave; particularly in terms of the distribution of gains of globalization for developing countries and the limited degrees of freedom for to affecting global outcomes.

In general, these approaches emphasize that international trade takes place under "unequal conditions" between the "north" (center, developed countries) and the "south" (periphery, underdeveloped economies). In general the "north" is where technical change mostly originates and where physical, human and institutional infrastructure is superior.

A main conclusion of this heterodox literature is an asymmetrical distribution of the benefits of international trade between center and periphery. In addition, it is posed that there are not enough degrees of freedom in the international system to allow the south (periphery) to choose its own rate of economic growth or terms of trade, which are determined by macroeconomic equilibrium complemented by a certain institutional base in the north. In turn, the south (periphery) would carry a major share of worldwide economic adjustment costs to global shocks like deterioration in terms of trade, fall in world demand and slowdowns in capital flows (see Lance Taylor, 1983, ch. 10, for an exposition of these theories). In addition, it is posed that main global economic decisions are made by the governments of the north who hold the main decision-making power in the institutions that "govern" the global economy.

Evaluation

The economic order of early 21st century certainly offers opportunities to developing countries and other actors in the global economy. The drastic reductions in barriers to international trade have opened the door for export-led growth. In fact, for small and medium size economies with limited internal markets[4], the possibilities for rapid economic growth lie, to a large extent, in production oriented towards international markets. The historical experience of the last three decades shows that countries that have managed to grow at very rapid rates, say 7%, 8% or more per year, have all relied on strong export growth, with exports expanding at a faster rate than GDP. This has been the case of East Asia since the 1960s (up to their current crisis), China, since the mid 1970s, Chile since the mid 1980s and others.

Another argument in favor of globalization is that it expands freedom (Micklethwit and Noolridge, 2000). The idea is that globalization, by increasing opportunities it also rises the possibilities to exercise freedom. Interestingly a similar argument is put forward by Amartya Sen (1999), regarding development rather than globalization in his recent book, entitled precisely, Development as Freedom.

Globalization also increases the potential access to a wide variety of consumption goods, new technologies, knowledge, ideas and international best practices in different fields and realms. This can be a new product design, a new investment project, a new production technology, a new managerial practice, it can even be a certain set of institutions that has proved successful in other places, and, eventually, a model of society.

Of course the mere acquisition or imitation of foreign products, technologies or foreign social models to local conditions with all their specificities and idiosyncratic features is not a guarantee of success. It is just a potential benefit (or cost if used in misleading fashion) derived from broadening the set of choices open to the participants of the global economy.

[4] This is also valid for large economies; in fact, China started to growth at a faster pace since 1977-78, after

Every coin has two sides; thus it is also important to recognize that globalization also poses some tensions and dilemmas to countries integrated to the world economy.[5] It is clear that globalization has spread unevenly across the developing world. Private capital inflows are largely concentrated in a group of large middle-income developing countries. For example, Sub-Saharan Africa and other poor countries in other continents receive less the benefit of trade, capital mobility and technological improvements developed in the north. Another tension of globalization is associated with the fact that in a more interdependent and inter-linked world economy any adverse global or regional shock, for example the Asian and Russian crisis of 1997-98 rapidly propagates to other economies. One propagation (contagion) mechanism at work can be a decline in the import volumes and/or changes in the real price of commodities (oil, copper, timber, etc). Economies that depend heavily on a few main commodities as their main source of export earnings and fiscal revenues can be hit hard by these shocks. Another transmission mechanism is asset markets. Highly integrated financial markets tend to transmit global, regional or local shocks much more rapidly than in past decades when financial markets were less integrated. Portfolio shifts affect exchange rates, interest rates and economic activity. As the volumes of financial intermediation and currency transactions are enormous nowadays, shocks can be greatly amplified in more or less synchronized fashion with destabilizing effects on many economies. This source of financial volatility was largely absent in the world of the 1950s, 1960s and early 1970s

it stimulated export-oriented growth and foreign direct investment.

[5] See Rodrik (1997), Sachs (1999), Solimano et al. (2000).

when multilateral lending, public financing, aid and foreign direct investment dominated global capital movements.

There is ample empirical evidence showing that uncertainty and volatility penalize capital formation (and productivity growth) with adverse effects on economic growth.[6] Thus instability and volatility can be ultimately viewed as a tax on growth and prosperity.

In many instances, this instability originates from abroad. However, the quality of the domestic policy response in the face of adverse external shocks matters. The nature and timing of the domestic policy response can either soften or increase the impact of these shocks.

Another tension of globalization lies in its social effects. As globalization is often associated with increased instability of output and employment, this affects, among other things, job security. As labor income is the main source of earnings for the majority of population under capitalism, job insecurity is socially disruptive and brings tensions to the fabric of society. In addition, flexibility in labor markets required to compete, successfully, in international markets, tends to erode long term work and personal relationships between firms and employees, workers and managers that traditionally give a sense of security to people. Another open discussion is whether foreign trade and globalization narrow or widen income disparities. Traditional trade theory suggesting factor price equalization across countries seem of little relevance in a world of large per capita income differentials (e. g. between say Sub-Saharan Africa and the OECD); moreover, convergence in income levels (per person) is, at least, very weak across regions and nations.

[6] See Pyndick and Solimano (1993).

In addition, globalization gives a premium to people with sophisticated skills, high levels of education, and entrepreneurial traits. These are people better equipped to survive and succeed in the more competitive world brought about by globalization. The mirror image of this is that unskilled labor, uneducated workers and marginalized population are likely to benefit less in a more competitive world economy.

Thus income and wealth inequality can be amplified, underscoring the need for public policy to correct these inegalitarian trends. Another critique of globalization is that it tends to transmit the cultural patterns of large countries to the rest of the world through imitation of consumption patterns, global mass media and other means of influence. This trend would, eventually, lead to homogenization of values, thereby reducing cultural diversity and national identities.

Institutional Challenges of Globalization

The institutional challenges of globalization can be geo-political, economic or both. A main geopolitical challenge of the era of globalization has been the emergence of an uni-polar world following the end of the Soviet Union as the other "superpower" besides the U.S. The end of the cold war induced the end of armed conflicts in certain areas (e.g. Asia, Central America) but brought new ones in Central Europe, for example in the former Yugoslavia and in some former Soviets republics. The building of new nation-states in what was the soviet block is still an unfolding process, after a near a decade of the dissolution of the Soviet Union (see Hobsbawm, 1999).

These developments have strained the capacity of global political institutions, such as the UN, to support nation-building in post-conflict countries and end existing armed conflicts of an internal nature in the post-cold war era. The challenges such as peace and security are ever present. Dealing appropriately with these issues is non-trivial and require considerable political will, financial support and consensus from the member countries.

The main economic challenges of globalization include the maintenance of a stable environment conducive to expanded trade, international investment and global economic growth. Social challenges entail a reduction in global poverty, less inequality among and within countries and less exclusion. In addition, the institutional financial architecture of the early 21^{st} century is facing several important challenges from globalization:

The maintenance of global and domestic financial stability is becoming a very complex task. Capital moves very fast across national boundaries responding to changes in relative asset returns flows, of information about investment opportunities and changes in national economic policies. As the Mexican, Asian and Russian crisis of the late 1990s show, the magnitude of external imbalances to be financed (and the outstanding financial liabilities to be served) in crisis situations are of such magnitude that strain (or even exceed) the existing resources available by the IMF and other multinational lending institutions, that have to prepare, in short time, emergency loans of an unprecedent size. Rescue packages of 10, 20, 30 billions dollars (or more) towards countries, before or after suffering speculative attacks on their currencies, were not uncommon in the second half of the 1990s and could be present in the future again.

International financial institutions and markets alike have serious problems to anticipate and then respond to macro and financial crisis, particularly in countries with serious governance problems. Moreover, when the crisis take place and the IFI's come with financial rescue packages, they create a moral hazard problem by giving, implicitly, incentives to market participants for excessive risk-taking in the anticipation of future bail-outs. Nevertheless, it is fair to note also that market participants and international private risk-grading agencies often fail to anticipate crisis (the later even tend to aggravate shocks in confidence when they downgrade countries in the midst of a crisis).

In addition, the exact dividing lines between balance of payments financing (the realm of the IMF) and development lending (the scope of multilateral developments banks) have become less clear. This was already the case in the 1980s when both Bretton Woods institutions started to lend in tandem for balance of payments support as private financing dried-up, as a consequence of the debt crisis. Again meeting the large external financial needs associated with the crisis of the 1990s required a combination of balance of payments support from the Bretton Woods Institutions and the Regional Development Banks. Several observers point-out that crisis management is more the realm of the IMF rather than of developments banks.

In order to strengthen the banking system at national level, and therefore strengthen the foundations of global financial stability, it is necessary to enforce the Basle Capital accord of 1998, signed by over 100 countries, that recommends core principles of bank lending, reserves, transparency and others. This should be complemented with appropriate mechanisms of bank's surveillance, and reporting of relevant information for both banks and corporations.

The 1990s saw, the irruption of an active global civil society/NGO movement with national counterparts, composed by environmentalist groups, social activists, labor unions, have started to challenge the policies and practices of the IFIs and prompting the quest for reform. The practice of conditionality attached to policy-based lending by the IFIs is becoming more controversial in consideration to issues such as ownership of programs, over-loading of conditions and internal political impact of externally-imposed policies.

As mentioned before globalization poses several economic challenges for national governments and its institutions of macroeconomic management. On the one hand, globalization is seen as a disciplinary force for national governments that undertake unsustainable economic policies (high fiscal deficits, unsound financial policies, etc) as these policies are penalized by international investors and global capital markets. However, the other side of this is that fiscal policy tends to lose its capacity to act as a counter cyclical instrument oriented to maintain full employment and pursue redistributive and social goals. The fact is that international financial markets are very sensitive on the stance of fiscal policy of a country and uses it as an indicator of the degree of "macroeconomic responsibility' of governments. Governments are encouraged to follow persistently austere fiscal policies in order to satisfy financial markets and gain credentials of serious fiscal behavior.

Governance for Globalization: Different Proposals

The current wave of globalization is a classic example of rapid economic change in need of an institutional infrastructure that could guarantee stability and growth at global, regional and national levels. In a way, we face nowadays a similar situation to that described in Karl Polany (1994)[7] when analyzing the social disruption and conflicts of the 1920s and 1930s following the first wave of globalization and marketization highlighting the need of "mediating institutions" to regulate change.

Several proposals of reform have been put forward in the last few years regarding the governance structure of the global economy and the global polity. These proposals have focused on the mission of the U.N system and the Bretton Wood institutions and other operative aspects of these institutions.

Here it is important to remember that global and regional institutions, either the UN or the Bretton Woods institutions are "owed" by national governments and therefore their reform will reflect the priorities of their member countries, particularly of those who make the largest financial contributions to these institutions. In general, it is fair to say that developing countries have a relatively limited ability to effectively affect the decision-making process that affect the world economy and its global institutions.

Let's focus on reform proposals for the International Financial Institutions (IFIs).

The IMF and the World Bank

Regarding the IMF proposals range from abolition (Milton Friedman among the academics, George Schultz among former policy makers) to reform, the latter including the proposals of the Meltzer report, which included academics such as Jeffrey Sachs, Allan Meltzer and others. Other proposals, particularly from financier George Soros is to convert the IMF in a global Central Bank complemented by an international credit-

[7] See K. Mc Robbie, K. Polany-Lewitt (2000) for a re-examination of Polany's view in light of contemporary globalization.

insurance corporation that would guarantee international loans (up to a limit) charging a fee.[8]

The main trust of most reform proposals, is to focus the IMF around two main functions: i) maintenance of global financial stability, including crisis-prevention and crisis-management. ii) lender of last resort. Regarding these functions, Fischer (1999) makes a distinction between crisis management and lender of last resort, noting that they do not always coincide. For example, historically, in the U.S., it was the Treasury, clearing-houses and even the financier J.P. Morgan in early 20th century that performed the role of lenders of last resort, crisis managers or both. Regarding the IMF, Fischer (1999) asserts that, in practice, the Fund, during the last two decades has played the role of crisis manager; in addition, the function of lender of last resort can also be played by the Fund noting that this would be facilitated if the Fund could 'create money'. However, the IMF is able, subject to the approval of its board of directors, to issue Special Drawings Rights (SDRs). This amounts to creating liquidity that can supplement existing reserve assets. Another important discussion relates to the implications of the 'Bagehot Principle' (1873) that states that the lender of last resort should lend freely to clients, at a penalty rate, on the basis of a marketable collateral in the ordinary course of business when there is no panic. One issue is to what extent is feasible the possibility of unlimited lending by the Fund in crisis situations. Another issue is the connection of this principle with conditionality. Some observers have argued that charging penalty interest rates in crisis situations should be a substitute for policy conditionality.

[8] See Micklethwait and Wooldridge (2000).

Coming back to the Soros' proposal, a global Central Bank would require a mandate to print global money, a feature unlikely to be given to the IMF or any other international institution. Nevertheless, as our previous discussion suggests the lender of last resort does not necessarily need to have the ability to create money, so the need of having a global Central Bank is less clear.

Other schemes, supplementing the crisis-prevention and crisis-management functions, call for a sort global bankruptcy courts, that would seek a more balanced distribution of the costs of financial crisis by engaging foreign lenders to share part of the costs of the financial crisis.

Another area of financial governance is the regulation of banking systems and the enforcement of capital standards and other practices of prudent banking behavior. A new, ambitious proposal for creating a World Financial Authority (WFA) is developed by Eatwell (2000) and Taylor (2000). The WFA, according to the authors, would be a global financial regulator performing the tasks of authorization, provision of information, surveillance, enforcement and development of policy.

A recent report on reform of the World Bank and the IMF is the Meltzer Report, commissioned by the U.S. Congress. The recommendations of that report center around some of the following issues:

- Focus the IMF in preserving global financial stability.
- Reducing World Bank financing to middle-income developing countries and increase funding to poorer economies via grant-making.
- Representation of member countries in the decision-making and governance structure of the Bretton Woods Institutions.

- Nature of policy conditionality.
- Effectiveness of counter-cyclical lending by the IFIs during crisis situations.

The issue of crowding-in and crowding-out of private capital inflows associated with lending by the BWI's is relevant. While private financing of infrastructure projects is generally available, the availability of private external financing for projects in the social sectors (education, health, social security) including support for institutional reform is much more limited. This makes for complementarities between international public and private lending to developing countries.

The role of the Bretton Woods Institutions is relevant in crisis situations, particularly when private capital flows withdraw from countries experiencing crisis. It is important to secure an effective counter-cyclical role for the Bretton Woods institutions in putting together external financing packages to all countries that need it, is important. Also, the concentration in the distribution of lending between middle income/large economies vis a vis lower income/small economies is another issue of relevance. In this connection, the Meltzer report argues in favor of the World Bank shifting its lending from to middle-income developing countries with access to international capital inflows (e.g., Argentina, Brazil, Mexico, others) towards assisting poor economies through grant-making. This recommendation raises important distributional questions regarding the allocation of international lending. However, it needs further critical analysis since middle-income developing countries do not always have uninterrupted access to global capital markets (e.g. during financial crisis); in addition, some middle-income developing countries (e.g., Brazil, India) have big contingents of poverty and marginalized people living within their frontiers and therefore fall in the mandate of the Bank as a poverty-reducing institution. Moreover, the financial implications for donor countries of going from a Bank to a grant-making agency are significant and its convenience and feasibility need to be clarified.

The topic of developing countries representation in the IFIs is very relevant as the capital structure of these institutions, established long ago, may not represent current economic realities of emerging and developing economies. In addition, developing countries representation and influence in the governance structure or the BWIs depends on their share on the capital structure of these institutions. In addition, there is not an equivalent to the G-7 or G-10 at the level of developing countries and transition economies. Mechanisms of information sharing and collective action for poor, middle income countries and transition economies are lacking.

During the 1980s and 1990s, domestic policy reform in borrowing countries was encouraged through conditionality by the Bretton Woods institutions in exchange for loans. Recent empirical evidence tends to show that unless borrowing countries are convinced of the need to adopt economic and institutional reforms, that in turn, have legislative and social acceptance at home, conditionality can be ineffective on even counter-productive.[9] A fresh look at the concepts and practice of conditionality, and the scope for partnership and participation is required.

In addition there is a need for a renewed look at the content of program design that fits suit to the era of globalization. This range from a careful consideration of the degree of fiscal austerity in adjustment programs, avoiding the design and implementation of unnecessary recessionary programs that can be socially destabilizing if they lead to

---

[9] See Collier, P. (2000).

increasing unemployment and poverty for a protracted period of time. Also, the IFIs are including now in program design issues of transparency and governance practices that are of a complex nature, politically sensitive and not always easy to implement.

Global and Regional Financial Institutions: the Mix

Let's turn now to the mix and balance between global financial institutions (IMF, World Bank) and regional financial institutions (e.g., regional and sub-regional development banks) in managing the challenges and financial needs of globalization. Is the current allocation of responsibilities and balance of influence between global and regional institutions adequate? What should be a workable division of labor between global and regional institutions, that avoids overlapping of lending and inter-agency competition? These are complex questions that require further reflection and analysis recent years, we have seen the emergence as relevant actors, in terms of volume of financing and policy advice, of regional development banks, (e.g. IADB, EBRD, ADB, AFDB)[10] and other sub-regional financial institutions, including reserve funds to face (limited) balance of payments needs. Some examples of these sub-regional institutions in Latin America are: CAF (Andean Development Corporation) and FLAR (Latin American Reserve Fund). An adequate balance between global and regional institutions requires an understanding of the comparatives advantages and corporate capabilities of each type of institution.

Regional financial institutions often have certain informational advantages about economic, political and cultural realities of member countries over global institutions which, by design, accommodate a larger set of countries from different continents. As we have seen, knowledge and local ownership of programs are essential to ensure a good development impact of projects and the political feasibility of the policy advice given by lending institutions. In addition, there is greater degree of country representation for developing countries in the most important decision-making bodies (Board of Governors and Board of Directors) of the regional institutions than in the executive boards of global institutions that tend to be influenced by G-7 countries. In contrast, regional development institutions are less exposed to global best practices and knowledge of a broad range of country experiences across continents than the global institutions like the IMF and the World Bank. In turn, conditionality is often more strict in global institutions whereas regional development banks tend to develop a pattern of interaction with client-countries closer, perhaps, to partnership.

It is important to reiterate, as mentioned before that, ultimately, regional and global institutions are "agents" that implement the mandates of the "principal" (the national governments). However, these mandates are filtered by: a) the bureaucratic structures of the regional and global IFIs, and b) the respective voting power of individual countries; in turn, a direct function of their economic importance in the world (or regional) economy. These two "filters" are very important for shaping the actual operation of global versus regional financial institutions and account for some differences in patterns of operational behavior, organizational cultures and representation of member countries between global and regional institutions.

---

[10] Inter American Development Banks (IADB), European Bank for Reconstruction and Development (EBRD), Asian Development Bank (ADB), African Development Bank (AFDB).

Regarding division of labor between global and regional financial institutions (more relevant for development banks) it is clear that co-financing of operations and more coordination in lending priorities and technical assistance is needed.

National Policies

A well functioning institutional system at world scale requires that reforms in global and regional institutions are complemented by reforms in national institutions and policies. In that sense, there must be a basic consistency between the global economic regime promoted by the global institutions and the policy regimes at national level. For example, if global institutions promote free trade, then the trade regime of member nations must be consistent with an open trade system. In turn, global priorities and global rules of the game, must ultimately be consistent with the national priorities of developed, developing and transition economies. This exercise at harmonization of priorities and policies at the different levels is not simple, again developing country voice and representation matters here.

Turning to the content of national policies in the era of globalization, it is often argued that globalization, besides its potential for enhancing global growth, tends to reduce the influence of domestic economic and social policies on development outcomes. Thus, an important question is to what extent it is possible to design national policy packages that regain a greater degree of national autonomy in pursuing policy objectives of full employment, stable growth and a more equitable income distribution. A focus on vulnerability-mitigation policies and social equity is appropriate. At the level of macroeconomic policy, the issue is how to define exchange rate, fiscal policies, capital account regimes (e.g., including a discussion of taxes on short-term capital flows) that reduce the vulnerability of the national economy to external shocks and global business-cycles. In the field of macroeconomic management, there is a need to explore the room for counter-cyclical fiscal policy. Regarding the exchange rate regime, flexible exchange rates, dollarization, currency boards and monetary unions are being considered now as better alternatives than fixed exchange rates and exchange rates bands. However, it is useful to remind that exchange rate regimes need to be discussed along with other policy fundamentals.

Social policy in the era of globalization is a very important topic per se.[11] The experience of the 1990s, shows that excessive volatility needs to be counteracted by appropriate social institutions that offer social insurance and economic security to people. Another lesson that can be extracted from the 1990s is that targeting in the delivery of social services tends to leave out the middle class. A fresh look at issues of universality versus targeting in the access to social services is needed. In addition, the device of adequate institutions of conflict management is very important in societies afflicted by significant inequality of income and wealth by regional fragmentation or ethnic diversity.

Concluding Remarks

Globalization, the main economic trend of the early 21st century offers a significant potential for expanded trade, international investment and technological advance of which developing countries can benefit. However, so far these benefits of globalization and the gains of increased global integration are unevenly distributed across and within nations. In addition, global interdependence has come along with significant

[11] See Solimano (1998, 1999, 2000) for a discussion of these issues.

macroeconomic volatility, and several serious financial crisis developed in the second half of the 1990s. We are living in a world of more possibilities but also of increased risks.

These features of globalization require an adequate institutional response that ensures stability, steady prosperity and a more equitable distribution of the rewards of globalization. The existing global institutional matrix was formed in the mid 1940s, around the UN system and the Bretton Wood institutions under a different balance of power across nations in a world of fixed exchange rates and very limited private capital mobility. Later, since the 1960s regional financial institutions emerged on account of greater autonomy of different regions and the expanded financial needs of the development process. This paper reviewed different proposals of reform of the international financial institutions, roles of the IMF and World Bank, highlighting implications for developing countries regarding policy conditionality, counter-cyclical role of lending by multilaterals, the concentration of financing to middle income versus low income developing countries, access to liquidity at times of crisis and voice and representation mechanisms of developing nations in the decision-making process of these institutions.

The paper also stresses the need to reassess the allocation of responsibilities, coordination mechanisms and overlapping between Bretton Woods institutions and of regional financial institutions. The design of reforms of the IFI's must incorporate important considerations of corporate capabilities of each type of institutions. Institutional cultures are different between global and regional institutions as well as the nature of knowledge (global vs. regional) generated and disseminated by each type of institutions. Furthermore, differences arise in the patterns of interaction with client-countries and in the representation-mechanisms in both global and regional IFIs. Finally, the paper also calls attention of the need for global and national policy harmonization, structured around growth-oriented policies that reduce volatility and promote social equity.

References

Bacha, E. (1978) "An Interpretational of Unequal Exchange from Prebisch-Singer to Emmanuel" Journal of Development Economic 5, 319-330, North Holland.

Bagehot, W. (1873) Lombard Street: A Description of the Money Market. London: William Dowes and Sons.

Bhagwati, J. (2000) "Globalization in your face" Foreign Affairs, July/August pp. 134-139.

Collier, P. (2000) "Consensus-Building, Knowledge and Conditionality" Paper presented at the Annual Bank Conference on Development Economics, The World Bank.

Eatwell, J. (2000) "The Challenges Facing International Financial Regulation" mimeo. Queens College, Camibridge, U.K.

Eatwell, J. and L. Taylor (2000) Global Finance at Risk: The Case for International Regulation, New York: Policy Press.

Emmanuel, A. (1972) Unequal Exchange: A Study of Imperialism, New York: Monthly Review.

Fischer, S. (1999) "On the Need for an International Lender of Last Resort" The Journal of Economic Perspectives, Vol. 13, Number 14, Fall, pp. 85-94.

Hobsbawm, E. (1999). On the Edge of a New Century, Free Press, New York.

Kaul, I., I. Grunberg and M. Stern (1999) Global Public Goods. International Cooperation in the 21st century. Oxord University Press, New York.

Mc Robbie, K. and K. Polanyi-Levitt, editors (2000) Karl Polanyi in Vienna. The Contemporary Significance of The Great Transformation. Black Rose Books, Montreal, New York, London.

Micklethwait, J. and A. Wooldridge (2000) A Future Perfect. The Challenge and Hidden Promise of Globalization. Crown Business.

Mundell, R. (2000) "A Reconsideration of the Twentieth Century" The American Economic Review, June.

Pyndick, R and A. Solimano (1993). "Irreversibility and Aggregate Investment" Macroeconomics Annual, National Bureau of Economic Research, Cambridge, MA.

Prebisch, R. (1950) Economic Development of Latin America and its Principal Problems New York: United Nations.

Polanyi, K. (1994) The Great Transformation. The Political and Economic Origins of Our Time, Beacon Press, Boston.

Rodrik, D. (1997) Has Globalization Gone too Far? Institute of International Economics, Washington, DC.

Sachs, J. (1999) Making Globalization Work? The Economist.

Sen, A. (1999) Development as Freedom. Alfred A. Knop, New York.

Singer, H. (1950) "The Distribution of Gains between Investing and Developing Countries" American Economic Review 40,473-85.

Solimano, A. editor (1998) Social Inequality. Values, Gowth and the State. The University of Michigan Press.

Solimano, A. (1999) "Globalization and National Development at the End of the 20th century". Policy Research Working Paper, 2137, the World Bank.

Solimano, A. (1999) "Beyond Unequal Development: An Overview" Policy Research Working Paper, 2091, The World Bank.

Solimano, A., E. Aninat and N. Birdsall editors (2000) Distributive Justice and Economic Development. The University of Michigan Press.

Soros, G. (1998) The Crisis of Global Capitalism. Open Society Endangered. Public Affairs, New York.

Taylor, L. (1983) Structuralism Macroeconomics Basic Books, New York.

Policy Research Working Paper Series

	Title	Author	Date	Contact for paper
WPS2493	Annuity Markets in Comparative Perspective: Do Consumers Get Their Money's Worth?	Estelle James Dimitri Vittas	November 2000	A. Yaptenco 31823
WPS2494	The Relevance of Index Funds for Pension Investment in Equities	Ajay Shah Kshama Fernandes	November 2000	A. Yaptenco 31823
WPS2495	The Australian Annuity Market	David M. Knox	November 2000	A. Yaptenco 31823
WPS2496	Perspectives on the Sources of Heterogeneity in Indian Industry	Somik V. Lall G. Chris Rodrigo	November 2000	R. Yazigi 37176
WPS2497	State Policies and Women's Autonomy in China, India, and the Republic of Korea, 1950–2000: Lessons from Contrasting Experiences	Monica Das Gupta Sunhwa Lee Patricia Uberoi Danning Wang Lihong Wang Xiaodan Zhang	November 2000	M. Das Gupta 31983
WPS2498	Sustaining Economic Welfare: Estimating Changes in Per Capita Wealth	Kirk Hamilton	November 2000	L. Rivera 82819
WPS2499	The Treatment of Non-Essential Inputs in a Cobb-Douglas Technology: An Application to Mexican Rural Household-Level Data	Isidro Soloaga	December 2000	L. Tabada 36896
WPS2500	Investigating Corruption	Canice Prendergast	December 2000	H. Sladovich 37698
WPS2501	Anti-Corruption Policies and Programs: A Framework for Evaluation	Jeff Huther Anwar Shah	December 2000	A. Santos 31675
WPS2502	Implications of the Currency Crisis for Exchange Rate Arrangements in Emerging East Asia	Masahiro Kawai Shigeru Akiyama	December 2000	A. Azarcon 36049
WPS2503	Proposed Strategy for a Regional Exchange Rate Arrangement in Post-Crisis East Asia	Masahiro Kawai Shinji Takagi	December 2000	A. Azarcon 36049
WPS2504	Social Capital and the Quality of Government: Evidence from the United States	Stephen Knack	December 2000	P. Sintim-Aboagye 38526

Policy Research Working Paper Series

	Title	Author	Date	Contact for paper
WPS2505	Family Altruism and Incentives	Roberta Gatti	December 2000	R. Bonfield 31248
WPS2506	Ethnicity and Wage Determination in Ghana	Abigail Barr Abena Oduro	December 2000	R. Bonfield 31248
WPS2507	Public Expenditures and Environmental Protection: When Is the Cost of Funds Irrelevant?	Gunnar S. Eskeland	December 2000	H. Sladovich 37698
WPS2508	Sources of Financial Assistance for Households Suffering an Adult Death in Kagera, Tanzania	Mattias Lundberg Mead Over Phare Mujinja	December 2000	V. Soukhanov 35271
WPS2509	How Tax Policy and Incentives Affect Foreign Direct Investment: A Review	Jacques Morisset Neda Pirnia	December 2000	N. Busjeet 33997
WPS2510	Environmental Protection and Optimal Taxation	Gunnar S. Eskeland	December 2000	H. Sladovich 37698
WPS2511	Monetary Policy under Flexible Exchange Rates: An Introduction to Inflation Targeting	Pierre-Richard Agénor	December 2000	M. Gosiengfiao 33363
WPS2512	Quantifying the Impact of Technical Barriers to Trade: A Framework for Analysis	Keith E. Maskus John S. Wilson Tsunehiro Otsuki	December 2000	L. Tabada 36896
WPS2513	Do State Holding Companies Facilitate Private Participation in the Water Sector? Evidence from Côte d'Ivoire, the Gambia, Guinea, and Senegal	Michel Kerf	December 2000	M. Leon 36151
WPS2514	Intersectoral Dynamics and Economic Growth in Ecuador	Norbert M. Fiess Dorte Verner	January 2001	A. Pillay 88046
WPS2515	Firm-Level Survey Provides Data on Asia's Corporate Crisis and Recovery	Mary Hallward-Driemeier	January 2001	E. Khine 37471
WPS2516	Does Decentralization Increase Responsiveness to Local Needs? Evidence from Bolivia	Jean-Paul Faguet	January 2001	H. Sladovich 37698
WPS2517	The Effect of International Monetary Fund and World Bank Programs on Poverty	William Easterly	January 2001	K. Labrie 31001